No. 14204

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES M. FIDLER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONER.

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Jurisdictional Statement.

This petition for review [R. 151-153] involves deficiencies in federal income taxes for the calendar years 1944, 1945 and 1946 in the respective amounts of $7,316.60, $10,293.79 and $6,992.74 [R. 150-151]. On January 31, 1950, the Commissioner of Internal Revenue mailed to the taxpayer-petitioner a notice of deficiency in taxes for said years and statement [R. 14-20]. Within ninety days thereafter and on April 26, 1950, the petitioner filed a petition with the Tax Court of the United States for the redetermination of said deficiencies in taxes under the provisions of Section 272 of the Internal Revenue Code [R. 6-20]. The decision of the Tax Court sustaining the deficiencies in taxes was entered on Sep-

tember 29, 1953 [R. 151]. The proceeding is brought to this Court by petition for review filed December 18, 1953 [R. 151-153], pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

Opinion Below.

The opinion of the Tax Court, promulgated September 25, 1953, is reported as 20 T. C. No. 149.

Statement of the Case.

Two questions are presented for decision:

First: Did payments in the sum of $800.00 per month which petitioner made during the period from April 1, 1944 through December 31, 1946, to his former wife, Ruth Law Fidler, as alimony and for her support and maintenance subsequent to a decree of divorce rendered on March 20, 1944, constitute periodic payments within the purview of Section 22(k) of the Internal Revenue Code, so as to entitle petitioner to deduct such payments pursuant to Section 23(u) in his income tax returns for the years 1944, 1945 and 1946?

Second: Did a loss in the sum of $4,750.00 which petitioner sustained in 1945 when he sold for the sum of $250.00 a stock of literary properties which he had purchased in 1937 for the sum of $5,000.00 represent an ordinary loss which he was entitled to deduct in full under Section 23(e) of the Internal Revenue Code, or did such loss constitute one from the sale of a capital asset held for more than six months, and which was therefore subject to the limitations of Section 117(b) and (d) of the Internal Revenue Code?

The facts in the case are stated below substantially as they appear in the decision of the Tax Court [R. 124-140]:

Petitioner is a resident of Los Angeles, California. He filed his income tax returns for the calendar years 1944, 1945 and 1946 with the collector of internal revenue for the sixth district of California at Los Angeles.

In 1936 petitioner was married to Ruth Law Fidler, sometimes known as Roberta Law Fidler and Roberta L. Fidler (hereinafter referred to as "Ruth Fidler").

There was no issue of this marriage, and in 1942 petitioner and Ruth Fidler adopted a newly-born baby girl.

Thereafter, petitioner and Ruth Fidler became separated, and on August 20, 1943, they entered into a written agreement which provided, among other things, that petitioner should have the exclusive custody and control of the minor child, subject to Ruth Fidler's right to reasonable visitation; that upon the execution of the agreement, Ruth Fidler should receive, as her share and in full division of the property of the parties, a certain Packard automobile and $20,000.00 in cash or securities; and that, in addition thereto, petitioner would pay to Ruth Fidler, in full and final payment for her support, maintenance and alimony, the sum of $30,000.00 in monthly installments of $500.00 per month, commencing on September 1, 1943. Petitioner's obligation to make such payments at the rate of $500.00 per month to Ruth Fidler for her support and maintenance was evidenced by two promissory notes executed by petitioner and delivered to her, concurrently with the execution of said agreement, and the terms of the notes were set forth in

full in said agreement. One of the notes provided for the payment to Ruth Fidler of the sum of $18,000.00, payable in consecutive, monthly installments of $500.00 per month commencing on September 1, 1943. The second note provided for the payment of the sum of $12,000.00, payable in consecutive, monthly installments of $500.00 per month, commencing on October 1, 1946. Each note contained a provision that in the event petitioner defaulted in the payment of any installment when due, the whole note might become immediately due and payable at the option of Ruth Fidler or the holder thereof, and that should suit be commenced to enforce payment of the note, petitioner would pay such additional sums as attorney's fees as the Court might adjudge to be reasonable. The $12,000.00 note, only, contained the following additional provision:

> "This promissory note is given by the undersigned to the payee in accordance with an Agreement executed by and between the parties this date, for the support and maintenance of the payee. This note shall become absolutely void and of no effect upon any remarriage of the payee and whether or not such remarriage shall be valid."

The agreement of August 20, 1943, was prepared by a firm of Los Angeles attorneys who represented Ruth Fidler.

On October 21, 1943, an amendment to the agreement of August 20th was executed by petitioner and Ruth Fidler, the effect of which was to eliminate the provision above-quoted appearing in the $12,000.00 note, and Ruth Fidler acknowledged receipt of the $12,000.00 note, as thus amended, and also the $18,000.00 note above referred to.

On December 16, 1943, the aforesaid agreement was again supplemented and amended to provide, in effect, that Ruth Fidler should have exclusive custody and control of the minor child of the parties for a period of six months during each year and that petitioner should have the exclusive custody and control of the child for a like period of six months during each year; and that during such times as Ruth Fidler should have the custody and control of the child petitioner would pay the costs of a nurse, food, clothing and medical expense for the child.

On February 4, 1944, the petitioner and Ruth Fidler entered into a new agreement, which superseded their previous agreements. This new agreement also made provision for the custody and support of the minor child of the parties, and settled all rights and claims in respect of property and support between the parties. It, in substance, provided among other things that each of the parties should have the exclusive custody and control of their minor child for six months during each year, and that petitioner would pay to Ruth Fidler for the care, support and maintenance of the child during the period that she should have its custody and control the sum of $200.00 per month as well as any extraordinary medical care and attention required for the child; that in addition to the Packard automobile and $20,000.00 in cash or securities theretofore transferred by petitioner to Ruth Fidler as her share of and in full division of the property of the parties, petitioner agreed to and did transfer to her an additional sum of $7,000.00 in cash or securities. In addition to the foregoing, and with respect to alimony,

support and maintenance for Ruth Fidler, the agreement provided as follows:

> "SEVENTH: In addition to the foregoing, and on account of full and final payment of maintenance and support, alimony and alimony *pendente lite* to Second Party, and counsel fees and costs in any pending or future action between the parties hereto, First Party does hereby re-deliver to Second Party, and Second Party will retain, those two (2) certain promissory notes, being the same notes described in Paragraph First of Amendment to Agreement of August 20, 1943, in words and figures as follows, to-wit: * * *"

After setting forth, verbatim, the terms of the two promissory notes hereinbefore referred to, as amended on October 21, 1943, the agreement went on to provide for additional payments in the form of a third promissory note as follows:

> "In addition to the foregoing and in full and final payment of maintenance and support, alimony and alimony *pendente lite* to Second Party, and counsel fees and costs in any pending or future action between the parties hereto, First Party will, upon the execution of the within instrument, make, execute and deliver unto Second Party one (1) promissory note, in words and figures as follows, to-wit:
>
> $16,200.00 Los Angeles, California
> February 4, 1944
>
> At the time stated after date, for value received, I promise to pay to Roberta L. Fidler, only at Los Angeles, California, the sum of Sixteen Thousand, Two Hundred ($16,200.00) Dollars, without interest. Principal payable in lawful money of the

United States. This note is payable in installments of Three Hundred ($300.00) Dollars each month, payable upon the first day of each and every calendar month subsequent to the first day of March, 1944, and any default in the payment of any installment when due shall cause the whole note to become immediately due and payable at the option of said Roberta L. Fidler. Should suit be commenced to enforce the payment of this note, I agree to pay such additional sum as the Court may adjudge reasonable as attorney's fees in said suit. Demand, presentment for payment, protest and notice of protest are hereby waived.

"This promissory note is given by the undersigned to the payee in accordance with an Agreement executed by and between the parties this date, on account of the support and maintenance of the payee. Should payor, at any time during the term hereof, not have a radio contract under the terms of which he receives a monthly sum equal to the monthly sum he is now receiving under his present radio contract, the monthly installments falling due hereunder during said periods shall be reduced in proportion to the amount of the reduction of his present radio contract, and should payor have no radio contract at all, then all monthly installments falling due hereunder during said period, shall be waived by payee, and payor shall not be required at any future time to pay the balance of any reduced, or waived payment, hereunder.

JAMES M. FIDLER
James M. Fidler
4362 Clayborn Avenue
Burbank, California.

"That Second Party accepts said three (3) promissory notes, for her support and maintenance and not

in lieu of property rights, upon the following conditions:

(a) In lieu of other provision for the support and maintenance of Second Party during her natural life;

(b) In full payment, discharge and satisfaction of all obligations or any thereof, on the part of First Party to maintain or support Second Party during her natural life;

(c) In full payment, discharge and satisfaction of counsel fees and costs in any pending or future action between the parties hereto, other than an action on said or any of said promissory notes.

"EIGHTH: That the installment payments provided in the three (3) promissory notes hereinabove set forth, being taxable to her as income, Second Party will, from and after the date hereof, file such income tax returns and/or declarations, both Federal and State, as are required by law, and will include therein all such support and maintenance payments received by her, and will pay all taxes shown to be due and payable under such returns and/or declarations.

"Should any of the monthly installments provided for in the said $16,200.00 promissory note, last above described, be reduced or waived and the payor not be required to make same, First Party will give to second Party, not for her support and maintenance, but as an absolute gift without condition, sufficient moneys to enable Second Party to pay her income taxes, both Federal and State, when due, on support and maintenance payments received from First Party, but not on income received by Second Party in excess thereof, without resort to the support and main-

tenance payments provided for in the two other promissory notes, above described, it being the intention of the parties hereto that Second Party will, during any period that the payments under said promissory note last above described are reduced or waived, have a net minimum sum of $500.00 per month for her support and maintenance."

In the preparation and execution of the agreement of February 4, 1944, petitioner and Ruth Fidler were each represented by attorneys of Los Angeles, California.

At the time of the execution of the agreement and for seceral years prior thereto, petitioner's principal business or occupation was that of radio commentator and newspaper columnist.

The "present radio contract" referred to in the agreement of February 4, 1944 (and in the amended decree of divorce hereinafter referred to) was a contract which was in force on February 4, 1944, and March 20, 1944, between petitioner and the sponsor of a weekly radio broadcast program under which petitioner was engaged to render his services as a commentator and reporter on said weekly radio program. The term of the radio contract was 26 weeks. The sponsor, however, had the option to renew and extend the contract of employment for additional, successive terms of 26 weeks' duration.

In 1944 Ruth Fidler, as plaintiff, instituted an action in the District Court of the State of Nevada in the County of White Pine against petitioner, as defendant, wherein she prayed that she be granted a divorce from petitioner and that the agreement of settlement and separation aforesaid of February 4, 1944, be approved by the Court.

Ruth Fidler was represented in said action by a firm of attorneys of Las Vegas, Nevada.

Petitioner never personally appeared in the Nevada divorce action, but authorized an attorney of Ely, Nevada, to appear for him.

The divorce action was tried at Ely, Nevada, on March 20, 1944, and a decree of divorce was rendered in favor of Ruth Fidler against petitioner.

The formal decree of divorce as signed by the judge of the Court adjudged and ordered as follows:

> "Now, Therefore, it is hereby Ordered, Adjudged and Decreed that the marriage relationship now and heretofore existing between plaintiff and defendant be and the same is hereby dissolved and the parties are restored to the status of single persons.
>
> "It Is Further Ordered, Adjudged and Decreed that that certain Settlement Agreement entered into between the parties, dated February 4, 1944, be and the same is hereby confirmed, ratified, approved and adopted as a part of this Decree.
>
> "It Is Further Ordered, Adjudged and Decreed that the defendant herein have the care, custody and control of the minor child, named Bobbe Fidler, Jr., until October 1, 1944, and thereafter the plaintiff is to have the custody of the child for the next ensuing six months, or until April 1, 1945; thereafter the custody of said child shall be distributed to the parties for six months each, until further order of this Court; that during the term plaintiff has custody of the said minor child, defendant shall pay to her for the care, support and maintenance of said child, the sum of Two Hundred ($200.00) Dollars per month.

"It Is Further Ordered, Adjudged and Decreed that the defendant shall pay to the plaintiff, in accordance with the terms of said Settlement Agreement, the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years.

"The Court herewith retains jurisdiction herein with reference to the said minor child for the purpose of making such orders as may hereafter appear to best serve the interest of said minor child.

"Dated and Done this 20th day of March, 1944.

HARRY M. WATSON,
District Judge."

The decree was inconsistent and ambiguous, in that while it "confirmed, ratified, approved and adopted as a part" of it the settlement agreement entered into between petitioner and Ruth Fidler on February 4, 1944, and ordered petitioner to make payments to Ruth Fidler "in accordance with the terms of said Settlement Agreement," it also provided that such payments should be "the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years."

When the Los Angeles attorney who had represented petitioner in the preparation of the settlement agreement of February 4, 1944, received a copy of the above decree, he immediately noted the inconsistency of its provisions and communicated with Ruth Fidler's attorneys in Las Vegas, Nevada, concerning it, and suggested that the decree be amended to reflect correctly the terms of the settlement agreement.

The inconsistency in the decree was due to inadvertence, and Ruth Fidler's attorneys agreed that the decree should be amended. A form of amended decree was prepared, and on September 11, 1944, Ruth Fidler's attorneys sent such form of amended decree to the attorney at Ely, Nevada, who had appeared for petitioner in the divorce action, and requested him to present the proposed amended decree to the court.

Thereafter, on September 18, 1944, upon application of the attorney the Court ordered that the decree of divorce be amended to recite correctly the terms and provisions of the agreement of settlement between petitioner and Ruth Fidler.

An amended decree, as filed on November 16, 1944, contained the exact terms and language as set forth in the original decree above-quoted except that the following paragraph was deleted:

> "It Is Further Ordered, Adjudged and Decreed that the defendant shall pay to the plaintiff, in accordance with the terms of said Settlement Agreement, the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years."

And in lieu thereof the following paragraphs were substituted:

> "It Is Further Ordered, Adjudged and Decreed that defendant shall pay to plaintiff in accordance with the terms of said Settlement Agreement the sum of Eight Hundred ($800.00) Dollars per month commencing forthwith and continuing for a period of four years and five months, the last monthly payment becoming due and payable on August 1, 1948, providing, however, that should defendant, at any

time before August 1, 1948, not have a radio contract under the terms of which he receives a monthly sum equal to the monthly sum he is now receiving under his present radio contract, monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars of said sum of Eight Hundred ($800.00) Dollars per month, shall be reduced in proportion to the amount of the reduction of his present radio contract, and should defendant have no radio contract at all, between the date hereof and said August 1, 1948, then monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars per month of said sum of Eight Hundred ($800.00) Dollars per month, shall be waived and shall not be made to plaintiff by defendant, and defendant shall not be required at any future time to pay to plaintiff the balance of any reduced, or waived, payments hereunder.

"It Is Further Ordered, Adjudged and Decreed, that all executory provisions of said Settlement Agreement which are not incorporated in this Decree in a plenary manner, are hereby declared to be binding on the respective parties hereto, and each of said parties is hereby ordered to do and perform all acts and obligations required to be done or performed by said executory provisions of said Settlement Agreement."

The amended decree was dated and signed by the same judge who had tried the divorce action and signed the original decree, in the following fashion:

"Dated and Done this 20th day of March, 1944.

/s/ Harry M. Watson,

District Judge."

On and prior to March 20, 1944, petitioner had paid and transferred to Ruth Fidler all moneys and properties

due to her under the terms of the settlement agreement of February 4, 1944, and paid certain sums required to be paid to her attorneys for representing her, and had made all payments to her which had then become due and payable to her pursuant to the terms of the promissory notes referred to and described in the agreement. After March 20, 1944, and during the years 1944, 1945 and 1946, petitioner also paid Ruth Fidler all sums which he was obligated to pay to her under the terms of the settlement agreement and the decree of divorce for the care, support and maintenance of the minor child of the parties. In addition to the foregoing, petitioner, pursuant to the terms of the agreement and decree, paid to Ruth Fidler as alimony and for her support and maintenance the sum of $800.00 each month during the period commencing April 1, 1944, and ending December 31, 1946.

The divorce decree as amended remained in full force and effect during the years 1945 and 1946.

During the period from February 4, 1944, to December 31, 1946, the sponsor of the weekly radio broadcast program hereinbefore referred to, to whom petitioner was under contract on February 4, and March 20, 1944, exercised its option to renew and extend said contract with the result that petitioner was continuously employed by this sponsor during this period and received, under the contract and the renewals and extensions thereof, monthly compensation equal to the monthly compensation which he had been receiving under said radio contract on February 4 and March 20, 1944.

On his income tax return for the calendar year 1944, petitioner claimed deductions in the sum of $9,000.00 by reason of alimony payments made to Ruth Fidler dur-

ing said year. Of this sum, $1,800.00 was paid by petitioner prior to the rendition of the decree of divorce on March 20, 1944, and at the trial of this proceeding, petitioner conceded that such sums aggregating $1,800.00 paid prior to the decree of divorce would not be properly deductible by him.

In his income tax returns for the calendar years 1945 and 1946 petitioner claimed deductions in each year in the sum of $9,600.00 by reason of the alimony payments made to Ruth Fidler during those years.

Respondent, in his notice of deficiency, disallowed the deductions claimed in each year upon the ground that "said amounts do not qualify as proper deductions under the provisions of section 23(u) of the Internal Revenue Code."

In the year 1937, petitioner acquired by assignment and transfer from William N. Selig a stock of literary properties consisting of all of Selig's literary rights, motion picture rights and other property rights, of every kind and nature, in approximately seventy-five published novels and stage plays, and approximately 2,000 original manuscripts, scenarios, and motion picture shooting scripts. Petitioner paid Selig $5,000.00 for these properties.

A Mr. Bentel, who was a literary agent and friend of petitioner, induced petitioner to buy the literary properties. Bentel advised petitioner that Selig was in failing health and was willing to sell these properties at what Bentel considered to be a reasonable price because among them were some properties which Bentel believed were quite good and which might be sold to motion picture studios at a profit.

Petitioner had an oral understanding with Bentel that Bentel would conduct a campaign to sell the stories, books, or plays, and that after petitioner recouped his $5,000.00 investment from such sales, he and Bentel would thereafter divide the returns on a "fifty-fifty" basis.

After the literary properties were acquired, a tabulation was made of them, and they were placed on display in the offices of Bentel.

Petitioner purchased the literary properties with the intention of attempting to sell some of them at a profit. They were not purchased for use in his work as a commentator or columnist, and none of them was ever used in such work. No sale of any of the literary properties was consummated prior to 1945, although at one time petitioner and Bentel thought a studio was going to purchase a book entitled "Under Two Flags." In 1945, petitioner sold all of the literary properties acquired from Selig for $250.00, to Eric Ergenbright, who was, and had been, an employee of petitioner for many years.

In his income tax return for the year 1945, petitioner claimed a deduction in the amount of $4,750.00 as an ordinary loss. In determining the deficiency the respondent disallowed the claimed deduction stating that the "ordinary loss claimed of $4,750.00 from sale of Selig Library of books and manuscripts has been determined to be a loss from the sale of capital assets held for more than six months and subject to the provisions of section 117(b) and (d) of the Internal Revenue Code."

The Tax Court of the United States sustained the respondent in his determinations [R. 140-151], and this petition seeks a review of the Tax Court's decision.

Specification of Errors.

1. The Tax Court erred in deciding that payments in the amounts of $9,000.00, $9,600.00 and $9,600.00 made by petitioner to his divorced wife during the years 1944, 1945 and 1946 constituted "installment payments" as distinguished from "periodic payments" within the meaning of Section 22(k) of the Internal Revenue Code and were not deductible by petitioner under the provisions of Section 23(u) of the Internal Revenue Code.

2. The Tax Court erred in deciding that the loss sustained by petitioner in the calendar year 1945 in the amount of $4,750.00 from the sale of books and manuscripts constituted a loss from the sale of capital assets held for more than six months and subject to the provisions of Section 117(b) and (d) of the Internal Revenue Code and in failing to decide that the loss was an ordinary business loss deductible in full under the provisions of Section 23(e).

Preliminary Summary of Argument.

I. The Alimony Question.

The payments made by the petitioner to Ruth Fidler of the sums of $800.00 each month during the period from April 1, 1944 to December 31, 1946, for her support and maintenance constituted "periodic payments" within the provisions of Section 22(k) of the Internal Revenue Code, and were therefore deductible by petitioner under the provisions of Section 23(u). The payments were not "installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument"

incident to the divorce decree because the amended divorce decree did not specify petitioner's obligation in a fixed and definite "principal sum." The amended divorce decree [R. 107], in effect, imposed upon petitioner the obligation to make monthly payments to his former wife for her support and maintenance, to and including August, 1948, in amounts of not more than $800.00 and not less than $500.00 per month, with the exact amount to be paid to depend on the amount of petitioner's income from his radio employment during said period.

The financial obligation which petitioner finally agreed to assume with respect to the support and maintenance of his wife was spelled out in their final Settlement Agreement dated February 4, 1944 [R. 65-84]. The promissory notes delivered on said date as part of said agreement were merely additional documentary evidence of said obligation. When said Settlement Agreement was adopted and incorporated by the Court as a part of its decree, the petitioner's obligation under said agreement and said promissory notes was merged into the Court's decree, and the decree fixed the nature and measure of petitioner's obligation. The decree did not impose two separate obligations upon petitioner in the amounts of $500.00 and $300.00 per month respectively, but rather imposed a single obligation to pay alimony in the maximum amount of $800.00 per month but subject to reduction to not less than $500.00 per month in the event of cessation or diminution of petitioner's radio employment income. The total amount which he would be required to thus pay was

not fixed and definite, but was variable, depending upon his future income. The payments, therefore, were not installment payments upon a specified "principal sum."

The object of Congress in enacting Sections 22(k) and 23(u) of the Internal Revenue Code was to eliminate the injustice and hardship which resulted under the pre-existing law whereby a husband when divorced from his wife and ordered by a court to support her was not allowed to deduct the amounts paid from his income tax. These statutory provisions should be reasonably construed to carry out the intent and purpose of Congress.

II. The Loss From the Sale of Literary Properties.

The loss which petitioner sustained in 1945 upon the sale of stock of literary properties was an ordinary business loss, deductible in full under the provisions of Section 23(e). The literary properties did not constitute "capital assets," but to the contrary, fell within those types of property expressly excluded from "capital assets" by Section 117(a)(1), *i.e.,* "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

ARGUMENT.

I.

The Payments Made by Petitioner to Ruth Fidler of the Sums of $800.00 Each Month During the Period From April 1, 1944 to December 31, 1946, for Her Support and Maintenance Constituted Periodic Payments Within the Provisions of Section 22(k) of the Internal Revenue Code, and Were Therefore Deductible by Petitioner Under the Terms of Section 23(u).

The issue to be decided depends upon the proper interpretation of provisions added to the Internal Revenue Code by Section 120 of the Revenue Act of 1942, 56 Stat. 798, c. 619, which presently appear as Sections 22(k) and 23(u) of the Internal Revenue Code. The pertinent portions of those provisions read as follows:

> "SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> "In computing net income there shall be allowed as deductions:
>
> * * * * * * * *
>
> "(u) Alimony, Etc., Payments.—In the case of a husband described in section 22(k), amounts includible under Section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. * * *
>
> "SEC. 22. GROSS INCOME.
>
> * * * * * * * *
>
> "(k) Alimony, Etc., Income.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments * * * received subsequent to such decree in discharge of, * * *

a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, * * * Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife * * * does not exceed 10 per centum of such principal sum. * * *"

The object of Section 22(k) was to do away with the apparent injustice under which a man divorced from his wife and ordered by a court to support her, was not allowed to deduct the amounts paid from his income tax.

Herbert v. Riddell (D. C. S. D. Cal.), 103 Fed. Supp. 369.

The legislative history demonstrates this purpose..

See:

Senate Report No. 163, Committee on Finance, 77th Cong., 2nd Sess., C. B. 1942-2, p. 568;

House Report No. 2233, Committee on Ways and Means, 77th Cong., 2nd Sess., C. B. 1942-2, p. 409 at p. 427.

See also:

Cox v. Commissioner (1949), 176 F. 2d 226, at 228.

In the House Report of Congress above referred to, it is stated (C. B. 1942-2, p. 409):

> "The existing law does not tax alimony payments to the wife who receives them, nor does it allow the husband to take any deduction on account of alimony payments made by him. He is fully taxable on his entire net income even though a large portion of his income goes to his wife as alimony or as separate maintenance payments. The increased surtax rates would intensify this hardship and in many cases the husband would not have sufficient income left after paying alimony to meet his income tax obligations.
>
> "The bill would correct this situation by taxing alimony and separate maintenance payments to the wife receiving them, and by relieving the husband from tax upon that portion of such payments which constitutes income to him under the present law. This treatment is provided only in cases of divorce or legal separation and applies only where the alimony or separate maintenance obligation is discharged in periodic payments. Moreover, the portion of such payments going to the support of minor children of the husband does not constitute income to the wife nor a deduction to the husband. The same is true with regard to payments in discharge of lump sum obligations, even though made in installments."

The statute covers two types of situations in the allocation of income for tax purposes between divorced parties. If there is a lump sum payment promised *in the nature of a property settlement,* this is not taxed to the wife whether

the money is paid in one payment or spread over a period of years. On the other hand, if the husband agrees or is ordered to pay the wife for her support regular payments either in indefinite amounts or for an indefinite period of time, the payments are "periodic," taxable to the wife, and constitute a deduction for the husband.

Cf.:

Estate of Frank Charles Smith, Deceased (C. C. A. 3rd, Nov. 13, 1953), 208 F. 2d 349.

In the case at bar, the payments involved made by the petitioner were not in settlement of property rights, but were for the support and maintenance of his former wife. They do not constitute "installment payments" because the divorce decree did not specify a fixed and "principal sum" which petitioner was obligated to pay to Ruth Fidler for her support and maintenance. They, therefore, constitute "periodic payments."

The term "periodic payments" is not expressly defined by Section 22(k).

"Periodic payments" are defined by Nelson, in *Divorce and Separation* (2nd Ed., pp. 30-31), as follows:

> "An allowance of permanent alimony, where payable in money, is either (1), a lump sum payable on or near the rendition of the decree of divorce, (2) a lump sum payable in installments, or (3) *an allowance of periodical payments* without limitation as to time or *for a fixed period without designation of the total amount to be paid.*" (Emphasis added.)

The foregoing definition by Nelson was approved and adopted by the Tax Court in its early decision of *Roland Keith Young,* 10 T. C. 724. In that case, a divorce de-

cree was rendered between the taxpayer and his wife, which incorporated and adopted the provisions of a written agreement entered into between them. Under the divorce decree, taxpayer was required, in accordance with the terms of the written agreement, to make total monthly payments to his former wife for her support for a limited priod of fifty months, *i. e.*, for November and December of 1940, and for the twelve months of the four succeeding years, 1941, 1942, 1943 and 1944, and thereafter no further payments would be required. The amounts to be paid during each year depended upon the amount of the net income of the taxpayer for the preceding year. If the net income of taxpayer in a preceding year amounted to $50,000.00, he was required to pay for support and maintenance $12,000.00, in monthly payments of $1,000.00. If, in any one or more of the four calendar years, beginning with the year 1940, his net income should fall below $50,000.00, the payments to be made by him in the next succeeding year were to be that portion of $12,000.00 which would be represented "by the fraction thereof of which the net income for the preceding year is the numerator and the sum of $50,000.00 is the denominator."

The taxpayer-husband made payments to his former wife in accordance with this formula and deducted such payments on his income tax returns on the theory that they constituted "periodic payments." The Commissioner contended that they constituted "installment payments." In ruling in favor of the taxpayer-husband, the Tax Court found as follows:

> "Neither the decree of divorce nor the terms of the agreement of February 20, 1940, which were incorporated in and adopted under the decree *obligated petitioner to pay to his former wife any total, fixed sum*

over the fifty-month period. Rather the payments were left indefinite in amount excepting as to the maximum amount for a year, dependent upon the annual earnings of the petitioner; and his future annual earnings could not be determined as of the date of the final decree, October 22, 1941. The divorce decree provided only a method for computing the amounts to be paid by petitioner in each one of the future years, and the maximum to be paid in any year and for any month if petitioner's net income should be $50,000.00.

"The payments which petitioner made pursuant to the divorce decree were alimony payments, and they were periodic payments."

In its opinion the Tax Court held, in part, as follows:

"Petitioner contends that the divorce decree, by its terms, did not obligate petitioner to pay his former wife a definite sum of money over the prescribed period of fifty months. He points out that it would not have been possible at the time the decree was entered to compute a lump sum or total sum from the provisions in the decree relating to the future payments because the future payments were dependent upon his future net income, and neither the future gross nor the future net income was fixed.

* * * * * * * *

"It is our conclusion that the payments were periodic payments as that term is used in Section 22(k). We find from all of the evidence that petitioner's contentions are correct. The divorce decree allowed to the former wife periodic (monthly) payments for a fixed period *without designation of the total amount to be paid.* Such payments are considered to be 'periodical payments' as distinguished from

'a lump sum payable in installments.' See Nelson, Divorce and Annulment (2d Ed.), sec. 14.23, vol. 2, pp. 30, 31.

"* * * They (petitioner and his former wife) agreed that the maximum total of the monthly pay ments would be $1,000.00. This plan of monthly payments was adopted by the court and set forth in the divorce decree. * * * The provisions in the divorce decree did no more than prescribe a maximum total monthly payment, based upon an annual net income of $50,000.00, and a method for computing monthly payments on the basis of any annual net income below $50,000.00. *These provisions did not fix any total sum as a fixed sum to be paid over the fixed period of fifty months.* Therefore, the payments in question were not payments 'discharging part of an obligation the principal sum of which is, in terms of money or property, specified in the decree.' It follows that the payments were not 'installment payments,' but were 'periodic payments' under section 22(k).

"Petitioner is entitled to deductions under Section 23(u) for the periodic payments which he made in 1942 and 1943." (Emphasis added.)

John H. Lee, 10 T. C. 834, also involved an agreement between the taxpayer-husband and his former wife wherein, just as in the case at bar, the amount which the husband would be required to pay his wife would be measured by and dependent upon the amount of his income. The taxpayer, Mr. Lee, had agreed to pay his wife, for a period of five years, 33⅓ per cent of the first $12,000.00 and 25 per cent of the excess, if any, of his annual net income over $12,000.00. He was to pay $46.15 each week and to make up the difference as soon as practicable after the end of each year. The husband deducted the

payments thus made during the years 1942 and 1943. The commissioner, just as in the case at bar, contended that the payments were not "periodic payments" but were "installments payments" within the meaning of Section 22(k), and therefore not deductible by petitioner.

The Tax Court, in overruling the Commissioner, made in part the following observations which are so clearly pertinent to the case at bar:

> "* * * The total payments to be made in the present case could not be as satisfactorily calculated in advance because there was no means of determining what the 'net income' of this petitioner might be.
>
> * * * * * * * *
>
> *"The Agreement of the parties in this case fixed no principal sum* and it was impossible to know in advance how much the petitioner would have to pay his wife. * * * *These payments do not come within the description of installment payments contained in Section 22(k). All other payments are to be considered as periodic payments and taxable to the wife rather than to the husband.* The period of five years fixed by the agreement is not sufficient, in view of the uncertainty as to the amount, to make these payments taxable to the husband under sections 22(k) and 23(u). Cf. Roland Keith Young, 10 T. C. 724." (Emphasis added.)

The foregoing interpretations by the Tax Court of the terms "periodic payments" and "principal sum" are reasonable and logical; there can be no doubt that the term "principal sum," as used in Section 22(k), contemplates a *fixed* and *definite* amount—"a total sum as a fixed sum" —"the total amount to be paid."

As Judge Yankwich stated in *Herbert v. Riddell, supra,*

> "Ordinarily, it might be difficult to draw a distinction between periodic payments and installment payments. For periodic payments may imply merely payments over a period of time. So may installment payments. But the Congress and the Treasury Department make it clear that 'periodic' payments are payments made at different times, which, as to *amount* or duration, are *indefinite.* Installments, on the other hand, are payments made periodically of amounts, equal or unequal, *as portions of a definite and established whole.* And this is what is meant by the phrase contained both in the section and regulation that the 'principal sum * * * is, in terms of money or property, specified in the decree of divorce or legal separation, or in an instrument incident thereto.' " (Emphasis added.)

This is but another form of expression of the concept voiced in the *Young* and *Lee* cases.

The Committee on Ways and Means of Congress, in making its report on this legislation, uses the term *"lump sum"* as synonymous with "principal sum" when, in referring to the class of payments which would not be considered as income to the wife, it makes the statement:

> "The same is true with regard to payments in discharge of lump sum obligations, even though made in installments." (See, House Report No. 2233, Committee on Ways and Means, 77th Congress, 2nd Session, C. B. 1942-2, p. 409.)

The Commissioner, in his regulation, at one point uses the expression "gross sum" as apparently synonymous with "principal sum." (Reg. 103, Sec. 19-22(k)-1 (as added by TD 5194, CB 1942-2, p. 56), subparagraph (c), Example (1).)

All of these expressions but corroborate the conclusion that a "principal sum," as used in Section 22(k), means a *fixed* and *definite* amount.

In view of the foregoing, can it be reasonably held that the divorce decree [R. 107-109] in this case specified "the principal sum," required by Section 22(k), in order to make the monthly payments non-deductible as "installment payments?" If so, what was the principal sum? Is it the amount arrived at by multiplying 53 months by the sum of $500."? That would have been but the *minimum* aggregate amount of the payments required. Can it be ascertained by multiplying 53 months by the sum of $800.00? That would have been but the *maximum* aggregate amount which Mr. Fidler might have been required to pay.

It is evident that the decree did not specify a principal sum, as required by Section 22(k). There was not a definite and fixed sum "specified" to be paid which could have ascertained by any form of mathematical calculation at the time that the divorce decree was rendered. And the answer must be determined as of the time that the divorce decree was rendered—and not in retrospect. When the Commissioner argued in the *Lee* case that a lump sum was specified in that case "because at the end of five years the exact amount would be known," the Tax Court responded: "That argument also carries too far, because eventually all uncertainties in every case will be resolved by the passing of time." (10 T. C. 836.) This statement is equally applicable to the case at bar.

The Tax Court, in concluding that a "principal sum" was specified in this case, seeks to disregard the legal effect of the decree of divorce and the payments ordered thereby. It seeks to ignore the substance of the obliga-

tion imposed upon petitioner by the decree. Instead, it relies upon the technical form of the promissory notes which petitioner had executed before the decree of divorce was rendered in order to conclude therefrom that petitioner's obligation under the divorce decree "consisted of two *separate components* of $500 and $300, each." [R. 142.] It then goes on to reason, in effect, that the $500.00 monthly payments which were still due and owing under the unexpired period covered by the first two notes could be calculated into a "principal sum" and that therefore these $500.00 monthly payments were "installment payments." It followed the same reasoning with respect to the third note which had been executed prior to the divorce decree with respect to the $300.00 monthly payments. In connection with the latter note, it held in effect that the contingent nature of this note, *i. e.,* the fact that petitioner's liability in respect of the $300.00 payment might be reduced or eliminated if petitioner should fail to obtain future radio contracts with at least the same level of compensation, did not detract from the fact that it specified a "principal sum" which petitioner was obligated to pay, under the reasoning employed in its previous decisions in *J. B. Steinel,* 10 T. C. 409; *Estate of Frank P. Orsatti,* 12 T. C. 188, and *Harold M. Fleming,* 14 T. C. 1308.

The conclusions, aforesaid, reached by the Tax Court are untenable for the reasons hereafter discussed.

The promissory notes involved were executed merely as additional evidence of the obligation which petitioner finally agreed to assume with respect to the support and maintenance of his wife as set forth in their final Settlement Agreement dated February 4, 1944 [R. 65-84]. Ruth Fidler, in her complaint for divorce against the peti-

tioner, requested that the Settlement Agreement be approved by the Court [R. 61]. The divorce decree expressly provided that the agreement was "confirmed, ratified, approved and *adopted*" as a part of the decree [R. 108].

The effect of the Court's action was to adopt and incorporate the Settlement Agreement into the decree. The decree, therefore, superseded the agreement and notes and became the basis of petitioner's liability to his former wife with respect to monthly payments to her for her support and maintenance.

42 C. J. S., p. 188, Footnote 50;

Spreckels v. Wakefield (C. C. A. 9th), 286 Fed. 465;

Hough v. Hough, 26 Cal. 2d 605, 160 P. 2d 15 (wherein the California court reviews and lists the decisions from numerous other jurisdictions on this point);

Herbert v. Riddell (U. S. D. C., Cal.), *supra,* 103 Fed. Supp. 369;

Lewis v. Lewis, 53 Nev. 398, 2 P. 2d 131, at 136.

In *Hough v. Hough, supra,* the Court states:

"A decree which incorporates an agreement is a decree of court nevertheless, and as soon as incorporated into the decree *the separation agreement is superseded by the decree, and the obligations imposed are not those imposed by contract, but are those imposed by decree, and enforceable as such. Once the contract is merged into the decree, the value attaching to the separation agreement is only historical.*" (Emphasis by the Court.)

As Judge Yankwich stated in *Herbert v. Riddell, Collector of Internal Revenue, supra:*

> "The obligation to pay derives not from the agreement of the parties, but from the order of the court, as the section just referred to (I. R. C., section 22(k)) clearly indicates. And courts have declined to recognize for this purpose voluntary agreements not made obligatory by court decree. *Smith v. Commissioner,* 1948, 2 Cir., 168 F. (2d) 446 (36 AFTR 1007); *Daine v. Commissioner,* 1948, 2 Cir., 168 F. (2) 449 (36 AFTR 1080); *Cox v. Commissioner,* 1949, 3 Cir., 176 F. (2) 226 (38 AFTR 301); *Commissioner v. Walsh,* 1949, U. S. App. D. C., 183 F. (2) 803 (39 AFTR 801)."

And, further:

> "And it is quite evident that, regardless of contract, the Congress intended that deductibility or non-deductibility shall be dependent on the legal obligation which ultimately compels the payment,—*i.e.,* the Court decree. See, *Commissioner v. Murray,* 1949, 2 Cir., 174 F. (2) 816 (37 AFTR 1520), 817."

After the rendition of the amended decree of divorce in this case, Ruth Fidler would not have had any right of action on those portions of the Settlement Agreement which had been incorporated in and made an operative part of the divorce decree, nor upon the promissory notes. Her remedy, in the event that petitioner had defaulted in the monthly payments ordered to be made for her support, would have been under the divorce decree, including such aids as execution, contempt, and other enforcement process of the Court, together with an action on the decree. (*Hough v. Hough, supra,* 160 P. 2d 15, at p. 19.)

The amended decree of divorce [R. 108] unequivocally demonstrates that the decree incorporated and specifically ordered the petitioner to pay to his wife monthly sums for her support in an amount not greater than $800.00 per month nor less than $500.00 per month. This order specifically covered the monthly payments which petitioner had agreed to make to his wife for her support and maintenance under the terms of the Settlement Agreement and the promissory notes executed and delivered as a part thereof, and superseded the contractual obligation imposed upon petitioner by said Settlement Agreement and promissory notes in this respect, by the following language [R. 108]:

> "It Is Further Ordered, Adjudged and Decreed, that defendant shall pay to plaintiff in accordance with the terms of said Settlement Agreement the sum of Eight Hundred ($800.00) Dollars per month commencing forthwith and continuing for a period of four years and five months, the last monthly payment becoming due and payable on August 1, 1948, providing, however, that should defendant, at any time before August 1, 1948, not have a radio contract under the terms of which he receives a monthly sum equal to the monthly sum he is now receiving under his present radio contract, monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars of said sum of Eight Hundred ($800.00) Dollars per month, shall be reduced in proportion to the amount of the reduction of his present radio contract, and should defendant have no radio contract at all, between the date hereof and said August 1, 1948, then monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars per month of said sum of Eight Hundred ($800.00) Dollars per month, shall be waived and shall not be made to

> plaintiff by defendant, and defendant shall not be required at any future time to pay to plaintiff the balance of any reduced, or waived, payments hereunder."

Insofar therefore as the monthly payments for support and maintenance are concerned, the above language from the decree imposed but a single obligation upon the petitioner. It in no manner separates such obligation into "two separate components." The decree does not specify that the $800.00 payments ordered shall consist of "two separate parts." The payment ordered by the Court is but a single payment. Whatever separate payments as such, might have been required under the terms of the promissory notes executed prior to the rendition of the decree of divorce were by the Court's decree, in effect, unified and consolidated into a single monthly payment. This is not only the substance and reality of the situation, but is, under the cases above cited, the actual legal effect of the decree.

The Tax Court, in its opinion, ignores the fact that the decree superseded the contractual obligations assumed by petitioner in the Property Settlement Agreement and promissory notes. It impliedly holds, notwithstanding the foregoing cases, that the agreement and promissory notes are still controlling. It states, by way of a passing remark set forth in a footnote as follows [R. 144]:

> "To the extent that there may be any conflict between provisions of the agreement and other parts of the decree, it is abundantly clear that it was the intention that the agreement was to be controlling. In one respect in which there was such a discrepancy, the decree was thereafter amended to conform to the agreement, as shown in our findings."

Certainly, it was the intention of the parties that the agreement which they executed on February 4, 1944, should be the basis for any decree or judgment thereafter rendered between them [see Paragraph Twenty-First of Agreement at R. 82]. But certainly the parties, or at least their attorneys, recognized that, as a matter of law, the decree would be controlling if it incorporated and adopted the Property Settlement Agreement as a part thereof. That is precisely why the attorneys for Mr. Fidler went to such great trouble to cause the decree to be amended to conform to the agreement of the parties when the first decree which was entered failed to accurately set forth the nature and extent of Mr. Fidler's obligation. See, in this regard, the extensive correspondence which took place between the attorneys for the parties following the rendition of the erroneous decree, and which led up to the correction thereof by the Court [Supplemental Stipulation of Facts, and Exs. 5-12, R. 111-122]. Obviously, the attorneys recognized that, irrespective of the intention of the parties, the Court's decree would be controlling over the agreement, and that therefore it was mandatory that the decree be amended to properly set forth the obligations which Mr. Fidler had assumed under the agreement. However, irrespective of what their intention might have been, the fact remains that, as a legal proposition, the decree of divorce, as amended, became controlling upon the parties.

Even in the absence of the controlling effect of the decree, and even if it be assumed *arguendo* that the agreement had not been incorporated and merged into the decree, so that it would be merely a question of construing the nature of the obligation imposed by the agreement alone, it is submitted that the efforts of the Tax Court to

separate the monthly payments for the support and maintenance of Mrs. Fidler into two separate obligations of $500.00 and $300.00 each is a hypertechnical reliance upon form and an unreasonable disregard of the clear meaning of the Property Settlement Agreement. (See, in this regard, the comments of Circuit Judge Hastie in *Estate of Frank Charles Smith, supra,* hereinafter referred to in greater detail.)

When the substance and realities of the situation which existed between Mr. and Mrs. Fidler are analyzed, it is clear that there is no proper justification for attempting to convert the monthly support payments into two separate and distinct obligations.

Under the first agreement of August 20, 1943, Mrs. Fidler had agreed to accept for her support and maintenance a sum of $500.00 per month for a minimum period of three years, with similar monthly payments of $500.00 for two more years provided that she did not remarry within such last two-year period. This obligation was set forth in the agreement in the form of two promissory notes, one in the sum of $18,000.00 dated August 20, 1943, providing for $500.00 monthly payments to be made immediately, and without provision for cessation in event of Mrs. Fidler's remarriage. These payments would have continued to and including the month of August, 1946. The contingent obligation for the following two years was set forth in the agreement as a separate promissory note in the sum of $12,000.00, with $500.00 monthly payments thereunder to commence on September 1, 1946. This note contained the provision that it would become ineffective upon remarriage of Mrs. Fidler [see agreement of August 20, 1943, at R. 86-96].

As part of said agreement it was further agreed that the exclusive custody of the child of the parties was to be with petitioner, and Mrs. Fidler was to receive a lump sum of $20,000.00 in cash or securities as her part of the property of the parties, together with a Packard automobile.

Apparently Mrs. Fidler was dissatisfied with the fact that she would not receive any support payments during the last two years of the contemplated five-year period in the event that she remarried. So, this condition was eliminated by the amendment of October 21, 1943 [Ex. "B," R. 96-99], with the result that petitioner's obligation, as of such date with respect to the support and maintenance of Mrs. Fidler was to make payments at the rate of $500.00 per month for a total of five years, irrespective of whether Mrs. Fidler remarried or not.

Then, on December 16, 1943, the agreement was again amended to accord Mrs. Fidler custody of the minor child for equal periods of time with petitioner, with the further obligation upon petitioner to pay all of the child's living expenses, including a nurse's care, while in the custody of Mrs. Fidler [Ex. "C," R. 99-101].

Thereafter, however, Mrs. Fidler retained another attorney and, finally the agreement of February 4, 1944, was negotiated and executed.

As of this date, petitioner's principal business was that of a radio commentator. Although he was then under contract to render his services on a weekly radio broadcast program, the term of said contract was only 26 weeks. And, while the sponsor of said program had the right to renew and extend said contract for additional periods of time, petitioner had no assurance that this

would be done [Stipulation of Facts, Par. XII, at R. 63-64, and Findings of Fact at R. 132]. Petitioner had experienced periods when he was not at all employed on radio, as for example, in 1940, 1941 and 1942, when his contract with one company had expired and he had not obtained another [R. 45].

It was undoubtedly on account of the uncertainty of petitioner's future income from his radio employment that the parties arrived at the plan finally agreed upon in the Settlement Agreement of February 4, 1944 [R. 65]. By this agreement, among other things, petitioner agreed to and did transfer and convey to Mrs. Fidler an additional $7,000.00 in cash or securities as her share of and in division of the properties of the parties, and agreed to pay $200.00 per month for the care and maintenance of the minor child during those periods when said child was in Mrs. Fidler's custody.

In addition to the foregoing, petitioner, in effect and substance, agreed to pay to Ruth Fidler for her support and maintenance of minimum of $500.00 and a maximum of $800.00 per month to and including the month of August, 1948, the exact amount to be paid to depend on the amount of his income from his radio employment during said period. This was accomplished by petitioner undertaking to continue to make consecutive payments as provided for under the two promissory notes, dated August 20, 1943, and October 21, 1943, theretofore executed and delivered to Mrs. Fidler, at the rate of $500.00 per month as called for by said notes, and in addition thereto, petitioner agreed to make additional concurrent payments of not to exceed $300.00 per month, but subject to reduction or waiver, in acccordance with the terms and con-

ditions of a third promissory note executed and delivered by petitioner to Mrs. Fidler on February 4, 1944.

Said third note contemplated and provided that petitioner would pay a maximum of $300.00 per month for 54 consecutive months. It further provided, however, that if petitioner during said period should not have a radio contract under the terms of which he received a monthly sum equal to that which he was receiving on February 4, 1944, under his then existing radio contract, then the monthly payments falling due under this note during said period would be reduced in proportion to the amount of the reduction of his then existing radio contract. And, if petitioner should have no radio contract at all, such monthly payments of $300.00 would be waived entirely, and petitioner would not be required at any future time to pay the balance of any reduced, or waived payments.

It thus appears that while Mrs. Fidler was to receive a minimum of $500.00 per month, she was entitled to receive not to exceed an additional $300.00 per month, if petitioner's earnings under his then existing or any subsequent radio contract equalled the earnings which he was receiving from his radio contract as of the date when said note was executed.

The notes, therefore, were intimately related in such way that they together, and with the agreement of which they were a part, provided continuing regular monthly payments of money for current maintenance and support of Mrs. Fidler in an amount not more than $800.00 and not less than $500.00 per month, until August 1, 1948.

That this was clearly the intention of the parties is demonstrated by the language of Paragraphs Seventh and

Eighth of the agreement of February 4th, reading as follows [R. 74-76]:

* * * * * * * *

"That Second Party accepts said three (3) promissory notes, for her support and maintenance and not in lieu of property rights, upon the following conditions:

"(a) In lieu of other provision for the support and maintenance of Second Party during her natural life;

"(b) In full payment, discharge and satisfaction of all obligations or any thereof, on the part of First Party to maintain or support Second Party during her natural life;

"(c) In full payment, discharge and satisfaction of counsel fees and costs in any pending or future action between the parties hereto, other than an action on said or any of said promissory notes.

"Eighth: That the installment payments provided in the three (3) promissory notes hereinabove set forth, being taxable to her as income, Second Party will, from and after the date hereof, file such income tax returns and/or declarations, both Federal and State, as are required by law, and will include therein all such support and maintenance payments received by her, and will pay all taxes shown to be due and payable under such returns and/or declarations.

"Should any of the monthly installments provided for in the said $16,200.00 promissory note, last above described, be reduced or waived and the payor not be required to make same, First Party will give to Second Party, not for her support and maintenance, but as an absolute gift without condition, sufficient moneys to enable Second Party to pay her income

taxes, both Federal and State, when due, on support and maintenance payments received from First Party, but not on income received by Second Party in excess thereof, without resort to the support and maintenance payments provided for in the two other promissory notes, above described, it being the intention of the parties hereto that Second Party will, during any period that the payments under said promissory note last above described are reduced or waived, have a net minimum sum of $500.00 per month for her support and maintenance."

The Tax Court seeks to ignore the substance of the transaction by refusing to read the three notes together; it, instead, views the first two notes as an isolated undertaking to pay a sum certain within five years. If we may paraphrase the language of Judge Hastie, in *Estate of Frank Charles Smith, supra,* "this refusal to read and interpret" the notes in relation to each other "results in an unreasonable disregard of the clear meaning of the agreement."

The statements made by the United States Court of Appeals for the District of Columbia in *Alfons B. Landa v. Commissioner* (decided Jan. 14, 1954), ... F. 2d. ..... (P-H, Federal Tax Service 1954, Par. 72,317), in an alimony case are appropriate to the case at bar. In that case, the taxpayer-husband had executed a promissory note to his wife agreeing to pay her a total of $30,000.00 in $200.00 monthly installments. The note stated that these sums were in repayment of an indebtedness which he owed her. The evidence, however, showed that there was no indebtedness and that the payments were made for the wife's support. The Tax Court, because of the form and language of the note, refused to permit the husband

to claim the payments as deductions. After two appeals to the Court of Appeals from adverse decisions by the Tax Court, the taxpayer finally prevailed. On the second and final appeal, decided on January 14, 1954, as aforesaid, the Court of Appeals, in reaching its conclusion in favor of the taxpayer, stated:

> "'* * * in the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding.' The purpose of this rule is manifest. Whenever taxation is allowed to depend upon form, rather than substance, the door is opened wide to distortion of the tax laws, which after all, represent the legislative judgment for an equitable distribution of the tax burden generally. *Clearly this purpose is not advanced by applying the rule only if it serves to increase the tax in a particular case. 'The taxpayer as well as the Commissioner of Internal Revenue is entitled to the benefit of the rule.'*" (Emphasis ours.)

The Tax Court has held herein that the contingency provided for in the agreement and decree, whereby the total payments which petitioner was ordered to pay to his wife for her support was expressly made subject to reduction in the event of cessation or diminution in his radio employment income, did not preclude the existence or ascertainment as of the date of the decree of an obligation on the part of petitioner specified in a "principal sum" In reaching this conclusion, the court relies upon its reasoning and conclusions in *J. B. Steinel,* 10 T. C. 409; *Estate of Orsatti,* 12 T. C. 188, and similar cases.

J. B. Steinel involved a decree of divorce which ordered the taxpayer husband to pay his former wife $100.00

monthly until $9,500.00 was paid, unless she remarried, in which event the remaining payments not in default would be cancelled. *Estate of Orsatti* also involved a similar situation—an agreement to pay $125.00 per week for a period of two years or until such time as the divorced wife should remarry or die, whichever first occurred. In these cases, the Tax Court concluded that the contingency involved only affected the "obligation," but did not affect the "principal sum" specified, and that therefore, the payments made were "installment payments" on a "principal sum" obligation. It is exceedingly difficult to understand this reasoning. If the contingency, even if it supposedly affects merely the "obligation," makes it impossible to know in advance how much the taxpayer will be required to pay his wife—if the total amount to be ultimately paid is uncertain or variable at the time that the decree is entered or the agreement is made—it would logically seem that there is no fixed and definite amount prescribed, and that therefore the payments are periodic payments and not installment payments of a specified lump sum or "principal sum" as required and contemplated by the statute.

In answer to this phase of the Tax Court's opinion, it is respectfully submitted that this Court should reject the Tax Court's interpretation just as the Courts of Appeals for the Second and Third Circuits have rejected it (We are advised that the same question is now pending before this Court for determination in *Benjamin Davidson v. Commissioner,* No. 13767.) Furthermore, and in the alternative, it is submitted that there are essential differences between the contingencies involved in the *Steinel* and *Orsatti* cases and that involved in the case at bar.

In *Baker v. Commissioner* (C. C. A. 2d, decided June 15, 1953), 205 F. 2d 269, the Court's opinion, on this point, reads as follows:

> "The separation agreement made between the taxpayer Mr. Baker and his former wife, and incorporated in the divorce decree, provided that he was to pay her $300 per month from September 1, 1946 to August 31, 1947, and $200 a month from September 1, 1947 to August 31, 1952, but that, should she die or remarry, his obligation to make any such payments thereafter would cease. The Tax Court held that these were 'installment payments'—within section 22(k) of the Internal Revenue Code—each discharging 'a part of an obligation the principal sum of which is * * * specified in the decree.' We do not agree.
>
> "Section 22(k) differentiates 'periodic payments' and 'installment payments.' The latter, as the wording shows, must be parts of a 'principal sum.' Here no such sum was explicitly stated in figures. But the Tax Court said: 'Simple arithmetic indicates that the principal sum to be paid was $15,600'—in other words, the addition of the several payments. *Were there no contingencies, this conclusion might be sound.* But there are contingencies which the Tax Court ignored. In doing so, it cited *J. B. Steinel,* 10 T. C. 409, where it had said (p. 410) that 'the word "obligation" is used in Section 22(k) in its general sense and includes obligations subject to contingencies where those contingencies have not arisen and have not avoided the obligation during the taxable years.' See to the same effect, *Estate of Frank P. Orsatti,* 12 T. C. 188, and *Harold M. Fleming v. Commissioner,* 14 T. C. 1308. We see no justification for this interpretation." (Emphasis ours.)

The Circuit Court, after pointing out the impossibility of predicting when the wife might remarry, went on to hold:

> "* * * the language of the statute before us in the instant case—'the principal sum * * * specified in the decree'—*clearly implies an amount of a fairly definite character,* and thus carries with it no such suggestion of uncertainty. Consequently, in this respect, we reverse the decision of the Tax Court." (Emphasis ours.)

The Court stated that the fact that the wife involved had actually remarried in September, 1949, was wholly irrelevant.

The Court of Appeals for the Third Circuit has likewise rejected the theory announced by the Tax Court in the *Steinel, Orsatti,* and other similar cases. In *Estate of Frank Charles Smith, Deceased,* decided on November 13, 1953, 208 F. 2d 349), a husband, under the terms of a property settlement agreement with his wife, executed as an incident to impending divorce litigation, had agreed with her, among other things, in the first paragraph of said agreement, to pay her $25,000.00 in ten equal and semi-annual installments commencing on the 15th day of February, 1947; in the second paragraph of said agreement he agreed to pay her, in addition, the sum of $300.00 every month beginning on the first day of December, 1946, for a period of 5 years; and in the third paragraph of the agreement, he agreed, in addition, to pay to her the sum of $100.00 per month on the first day of December, 1951, and on the first day of each calendar month thereafter, during the term of the remainder of her natural life.

There was a clause in the agreement that in the event of the death of the husband during the lifetime of the wife or in the event of the death of the wife or upon her remarriage, all payments provided for should cease, except certain other payments due under certain life insurance policies.

A divorce decree was granted to the taxpayer's wife but, unlike the case at bar, the decree did not incorporate the provisions of the agreement.

The husband-taxpayer made certain of the $2,500.00 semi-annual payments provided by the first paragraph of the agreement, and certain of the $300.00 monthly payments provided for by the second paragraph of the agreement. The Tax Court held that both classes of payments were "installment payments" and therefore not deductible by the husband. On appeal, the Third Circuit Court sustained the Tax Court with respect to the $2,500.00 installment payments on the $25,000.00 obligation, but reversed the Tax Court's decision on the non-deductibility of the $300.00 monthly payments and held that the theory adopted by the Tax Court in *Steinel* and similar cases was erroneous. In so holding, the Third Circuit Court stated:

> "The case turns upon the provisions of 22(k) and 23(u) of the Internal Revenue Code. The statute quite evidently covers two types of situations in the allocation of income for tax purposes between divorced parties. If there is a *lump sum payment promised in the nature of a property settlement* this is not taxed to the wife whether the money is paid in one payment or spread over a period of years. The latter is an 'installment' payment. On the other hand, if the husband agrees or is ordered to pay the

wife a sum of money as support regularly for an indefinite time that is a 'periodic' payment. The income therefrom is taxable to the wife and payments constitute a deduction for the husband. (Emphasis ours.)

* * * * * * * *

"Reference to the separation agreement will show that in addition to the $25,000 the husband further agreed to pay the wife $300 monthly for five years and $100 monthly thereafter for her life or until her remarriage. Nine of these $300 payments were made subsequent to the divorce decree in 1947. Taxpayer claims a deduction of $2700 therefor.

"The Commissioner taxes the position that since the sum total to be paid by the husband was mathematically calculable, payments made in liquidation of the agreement are 'installment' payments not taxed to the wife and for which the husband gets no deduction. This was the view of the Tax Court and is supported by a line of decisions in that court. Whether individual cases can be distinguished does not matter; the Tax Court judge in this case was perfectly right in relying on the theory supported by previous Tax Court decisions. *Steinel v. Commissioner,* 10 T. C. 409 (1948); *Orsatti v. Commissioner,* 12 T. C. 188 (1949); *Casey v. Commissioner,* 12 T. C. 224 (1949).

"Opposed to this line of Tax Court decisions is the Second Circuit's decision in *Baker v. Commissioner,* 205 F. 2d 369 (C. A. 2, 1953). All the Commissioner can do about this case is to say it is wrongly decided. We do not think it is wrongly decided. In the first place by the terms of this agreement, made between the Smiths prior to their divorce, there were three contingencies, the occurrence of any one of which would have relieved the taxpayer or his estate

from the obligatoin to make these monthly payments. First, if the husband died he was no longer liable. Second, if the wife died the husband was no longer liable. Third, if the wife remarried the husband was no longer liable. *The promise to pay was not therefore one which could be mathematically calculated as a certain obligation of the husband.*

"Furthermore. we do not read into the statute a requirement that the terms of payment must run over ten years in order that this become a periodic contract within the terms of the Act. It seems to us that this set of facts calls for a fairly clear application of the distinction indicated in Section 22(k), which provides for both the lump-sum payment on which it would be quite unfair to tax the wife, and the month-to-month kind of payment for support, in which the Congress was seeking relief for alimony-paying husbands. Each type was included in this contract. We think that the husband was entitled to a deduction by the terms of the statute for the $300 monthly he paid his former wife in 1947 by the terms of their agreement. In other words, he is entitled to the deduction of $2,700 which was denied him."

The Tax Court, in deciding the *Smith* case, had in effect pursued the same type of reasoning which it attempts to employ in the case at bar. It considered the $300.00 monthly payments provided for by the second paragraph of the agreement as a separate and distinct obligation from the $100.00 monthly payments provided for by the third paragraph. Circuit Judge Hastie, concurring in the decision by the Third Circuit Court of Appeals, pointed out:

"* * * I am sure that the Tax Court reached an incorrect result in the present case for a reason which has nothing to do with the new doctrine of the *Baker* case.

"Any rational reading of the first three paragraphs of the agreement in this case must reveal that, *while the first paragraph is the lump sum property settlement type of provision,* the second and third paragraphs are intimately related in such way that they together provide continuing regular monthly payments of money for current maintenance and support, albeit in decreased amount after five years, to the wife for life. It is not disputed that payments of this latter type are 'periodic payments' within the meaning of Section 22(k).

"The Tax Court avoids this conclusion by refusing to read the second and third paragraphs together, but rather viewing the second paragraph as an isolated undertaking to pay a sum certain within five years. *I think this refusal to read and interpret consecutive provisions in relation to each other results in an unreasonable disregard of the clear meaning of the document.* It would require that the two paragraphs be read together, thus necessitating a construction contrary to that of the Tax Court, but without reaching the problem of the *Baker* case." (Emphasis ours.)

Likewise, in the case at bar—the $27,000.00 in cash and securities which Mr. Fidler paid to his wife was the lump sum property settlement type of provision, and was not deductible by him, and would not have been deductible even if paid in three or four annual installments. But, the payments involved—the $800.00 monthly payments, considered together—were the periodic payments for support and maintenance which Congress contemplated and intended would be deductible by the husband and taxable to the recipient wife.

Furthermore, there are essential differences between the contingencies involved in the *Steinel* and *Orsatti* cases, and the case at bar.

The contingencies and conditions in the *Steinel* and *Orsatti* cases were conditions which qualified and pertained only to the underlying legal duty and obligation, arising out of the marital relationship, of the husband to support his wife. They were conditions which contemplated and would have resulted in a *complete avoidance and cancellation* of the husband's duty and *obligation* to support, in the event the condition occurred. They did not involve provisions which had for their purpose a *continuance of the obligation* to support, with but a *mere reduction* in the amounts to be paid.

On the other hand, in the case at bar, there was no condition involved, as in the *Steinel* and *Orsatti* cases, which provided for a *complete cancellation and termination of the husband's obligation* to make payments prior to the expiration of the specified period of time. There was no condition annexed to the obligation; Mr. Fidler's *obligation* to make payments was an *absolute* one which would continue throughout the specified period. The conditional provisions of the decree pertained to the *amounts* to be paid, as distinguished from the obligation to make any payments whatsoever in the event that a certain condition occurred.

The reasoning in the *Steinel* case that only the "obligation" is conditional and not the "principal sum" specified is illogical and unreasonable. However, it can in any event be applied only to a condition or contingency which *completely cancels* and *avoids* the obligation of the husband to continue to support his wife and make any pay-

ments at all. It is only because the condition would result in a complete cancellation of the duty and obligation to support and would cut off *all* future payments that it is possible to contend that the condition affects only the obligation, and not the ascertainability of the "principal sum" which Section 22(k) requires to be specified.

If the condition is one which does not completely cut off and cancel the obligation to pay, but merely reduces the sums thereafter payable, then it is not the "obligation" which is conditional, but rather it is the amount payable which is conditional. And, if the amount to be paid is a conditional and variable one, subject to merely reduction or change (as distinguished from complete cancellation) because of such things as fluctuations in the husband's future income, it is impossible to properly state that a "principal sum" has been specified in the decree.

The reasoning of the *Steinel* and *Orsatti* cases, therefore, cannot with propriety be extended to cover a situation wherein the occurrence of the condition would merely reduce the amounts thereafter payable by the husband to the wife. Such a result would be incompatible with the basic premise of the *Steinel* case that a "principal sum" is specified and that only the obligation to pay is conditional and subject to avoidance upon the occurrence of the condition.

There are other material differences between the contingencies involved in the *Orsatti* and *Steinel* cases and the case at bar. In those cases, the conditions involved were events which were entirely beyond the control and responsibility of the husband. They were events which in no manner were dependent upon the future variations or fluctuations in his income. In each case, at the time

that the decree was rendered, the husband knew in advance that insofar as he was concerned, he was obligated to his wife in a fixed and definite sum, and that the obligation was one beyond his power to vary or terminate. Whether the *obligation* was to be *cancelled* or terminated prematurely was dependent upon subsequent events entirely beyond his power and authority either to cause or to prevent.

In the case at bar, the contingency was to some degree, within the control of the husband. The formula was one dependent upon the husband's compensation—it was "geared" to his income. It was impossible for either the husband or wife to know at the time that the decree was entered how long he would continue to be employed as a radio commentator or what his earnings therefrom would be. It was therefore impossible to, and the divorce decree did not, specify "the principal sum" to be paid, but this was left variable and contingent upon Mr. Fidler's future income from his radio employment.

As further support for the contention that the rule of the *Steinel* case should be rejected, and in any event, should not be extended to a condition or contingency which merely reduces the amounts payable as distinguished from cancelling the obligation in its entirety, consider the effect of such an extention upon the applicability and interpretation of that provision of Section 22(k) reading as follows:

> "* * * except that an installment payment shall be considered a periodic payment for the purposes of this sub-section if such principal sum, by the terms

> of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, *but only to the extent that such installment payment for the taxable year of the wife * * * does not exceed 10 per centum of such principal sum.*" (Emphasis ours.)

Assume, for purposes of argument, that instead of being directed to make payments for only 53 months, Mr. Fidler had been ordered to do so for 10 years and 9 months, to January 1, 1955. Assume further, for the purposes of emphasizing the problem involved, that instead of the decree providing for a minimum payment of $500.00 per month, the minimum was fixed at $100.00, which provision for payment of an additional $700.00 instead of $300.00, so that the $800.00 maximum remained the same. (The substitution of the minimum sum of $100.00 for that of $500.00 would not in any way affect the problem whether or not a "principal sum" is specified or ascertainable in the decree.)

Let us further assume that during the period from March, 1944, to January 1, 1955, covered by the decree, Mr. Fidler's employment in radio had varied as follows: during 1944, 1945, and 1946, he continued to be employed under a contract under which he drew as much as he did at the time of the decree; that during the years 1947, 1948, 1949, and 1950, because of lack of a sponsor, he was not employed at all in radio; that during the years 1951 and 1952, he was employed for six months of each year at the same compensation; and that during the years 1953

and 1954 he was employed continuously at the same compensation which he had received when the divorce decree was rendered. Over the period involved, Mrs. Fidler would have received, under our hypothetical situation, the following:

Year Involved	Mr. Fidler's Employment Status	Amounts Received by Mrs. Fidler
Apr. to Dec., 1944	Employed throughout	$ 7,200
1945	" "	9,600
1946	" "	9,600
1947	Not employed	1,200
1948	" "	1,200
1949	" "	1,200
1950	" "	1,200
1951	Employed 6 months	5,400
1952	" " "	5,400
1953	Employed throughout	9,600
1954	" "	9,600
	Total paid over entire period	$61,200

Because the payments, under this hypothetical situation, now extend over a period of 10 years, they are includible in the income of the wife and deductible by the husband, *but* "only to the extent that such installment payment for the taxable year of the wife *does not exceed 10 per centum of such principal sum.*"

Mrs. Fidler, when she commenced to receive these payments, did not know how much she was going to receive, in the aggregate, over the hypothetical period of 10 years and 9 months. She could have received a maximum of $800.00 per month for 10 years and 9 months, a total of $103,200.00, or a minimum of $100.00 per month aggregating $12,900.00.

However, if the conclusion of the opinion filed in this case is correct that a "principal sum" was ascertainable, Mrs. Fidler was required to include in each calendar year payments received by her during such year to the extent that same did not exceed "10 per centum of such principal sum." And, Mr. Fidler, on the other hand, was entitled to deduct payments only to the extent of said 10%.

How, then, would Mr. and Mrs. Fidler have calculated their respective deductions and inclusions at the end of each calendar year, as they were required to do?

Would the Commissioner have asserted that they should have prepared their income tax returns upon the assumption that the maximum amount of $103,200.00 would be paid, and that said sum was the "principal sum" payable? If so, would the Commissioner have made the same assertion at the end of the year 1947 when the sums receivable by Mrs. Fidler amounted to only $1,200.00? Or at the end of the year 1950, when by reason of Mr. Fidler's lack of radio income for the years 1947, 1948, 1949 and 1950, the maximum amount payable by him under the terms of the decree would have already been reduced $33,600.00 to the sum of $69,600.00, even if it were assumed at said time that he would thereafter be employed at full compensation during the years 1951 through 1954?

And, finally, what would have been the position of the Commissioner at the end of the 10 year 9 month period, when for the first time, the exact amount of Mr. Fidler's maximum obligation was ascertainable, and it was then learned that he had paid his wife a total of but $61,200.00, of which 10% amounted to but $6,120?

Would the Commissioner have the right to assert that the deductions taken by Mr. Fidler in the year 1944 in the sum of $7,200.00 and in the years 1945, 1946, 1953 and 1954 in the sums of $9,600.00 in each year were excessive because they exceeded the annual ten per cent limitation of $6,120.00, and that Mrs. Fidler on the other hand had reported too much income in said years to the same extent? Would it have been necessary for the parties to amend their returns accordingly?

It is impossible to furnish the answer to these problems. They but illustrate the impropriety of attempting to hold that a "principal sum" has been specified in the decree or agreement in this case. The fact that these problems did not arise in the case at bar does not detract from the fact that they *could* have arisen, and that it is proper to keep them in mind in determining whether or not a "principal sum," within the intendment of Section 22(k) is ascertainable or specified in the decree.

In conclusion, it is respectfully submitted that since neither the agreement nor the decree of divorce directed the petitioner to pay a fixed "principal sum," it is apparent that the payments which were made cannot be considered as "installment payments" within the provisions of Section 22(k), but constituted periodic payments as contended by petitioner, and were therefore properly deductible by him.

In many cases of this kind wherein controversies arise between divorced husbands and the Bureau of Internal Revenue as to whether the wife should be compelled to pay income taxes on the support and maintenance payments received by her from her former husband, there are often circumstances or factors which indicate that the

wife, at the time of entering into a settlement agreement with her husband, was either inadequately represented or misinformed as to the tax consequences of the agreement, and was persuaded to enter into the agreement upon the understanding that she would not be required to pay income taxes upon the alimony payments which she would receive from her husband. Under such circumstances, the Commissioner, through his agents, may understandably seek to construe the agreement if possible so as to cause the tax consequence thereof to concur with the wife's understanding and to relieve her of the tax obligation. These circumstances are wholly absent in the case at bar. In the preparation of the final setlement agreement of February 4, 1944, Mrs. Fidler was represented by eminent counsel, and in Paragraph Eighth of the agreement, it is clearly and unequivocally provided that the support payments received by Mrs. Fidler would be taxable to her as income, and that she would include all such support and maintenance payments received by her in her income tax returns and would pay all taxes shown to be due thereunder. Both parties clearly understood that the payments would constitute taxable income to Mrs. Fidler.

It clearly appears, therefore, that petitioner's right to claim such deductions is not only sustained by the provisions of Sections 22(k) and 23(u), and the intention and purpose of Congress in enacting same, but that such right would be fully in accord with the intention and agreement of the parties that such payments would be taxable income to Mrs. Fidler.

While the agreement between the parties would not necessarily be binding upon this Court as to the tax consequences thereof, it is a circumstance which should be considered.

II.

The Loss Which Petitioner Sustained in 1945 Upon the Sale of the Stock of Literary Properties Was an Ordinary Business Loss, Deductible in Full Under the Provisions of Section 23(e). The Literary Properties Did Not Constitute "Capital Assets," but to the Contrary, Fell Within Those Types of Property Expressly Excluded From "Capital Assets" by Section 117(a)(1), i. e., "Stock in Trade of the Taxpayer or Other Property of a Kind Which Would Properly Be Included in the Inventory of the Taxpayer if on Hand at the Close of the Taxable Year, or Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His Trade or Business."

The facts with respect to the purchase by petitioner of this stock of literary properties for the sum of $5,000.00, his subsequent efforts and failure to sell certain stories therefrom, and his sale of said entire stock at a net loss of $4,750.00 have been hereinbefore set forth.

The provisions of the Internal Revenue Code involved are:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

* * * * * * * *

"(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

"(1) If incurred in trade or business; or.

"(2) If incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

* * * * * * * *

"SEC. 117. CAPITAL GAINS & LOSSES.

"(a) *Definitions:*—As used in this chapter—

"(1) *Capital Assets.*—the term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *."

It appears clear from petitioner's testimony that, in reliance upon the opinion and belief of his long-time friend, Mr. Bentel, an experienced literary property broker, that many of the stories and properties included in the stock could be resold at a profit, petitioner purchased the stock from Mr. Selig with the intention and hope of reselling some of the stories and rights at a profit to the motion picture studios [R. 36-37].

There can be no doubt that petitioner's testimony which is not disputed that he purchased these literary properties for one and only one purpose, and that was to attempt to make money by reselling some of the rights at a profit.

Petitioner did not purchase the properties with the intent or purpose of using them in his work as a radio commentator or columnist, nor did he ever use any of them for such purpose [R. 38-50].

While petitioner planned to primarily rely upon Mr. Bentel to find buyers for the properties, and for this reason the books and manuscripts were kept on display in Mr. Bentel's office and place of business for purposes

of exhibition to prospective customers, petitioner himself attempted to make sales therefrom [R. 18].

The books and manuscripts which represented and evidenced in physical form the literary property rights which petitioner had purchased from Mr. Selig, and which were tabulated, filed and kept on display in Mr. Bentel's office and place of business for purposes of exhibition to prospective customers [R. 39] can reasonably be considered as "stock in trade."

The properties were held by petitioner exclusively for sale to customers who could utilize such kinds of properties, and they were held by petitioner "in the ordinary cause of his trade or business" in that when Mr. Fidler purchased such literary properties with the intention of offering them for resale at a profit, he in effect embarked upon another "trade or business" in addition to his principal vocation and business of being a radio commentator and newspaper columnist.

It is clear, and it has been repeatedly held, that a person may engage in both a profession and business. While it is true that at the time that petitioner purchased the literary properties it was his intention to permit Mr. Bentel to find customers for same and handle the sales thereof, such fact in itself does not mean that petitioner was not engaged in the trade or business of selling such properties. Carrying on a business through agents is a very common practice.

See on this precise point:

Commissioner of Internal Revenue v. Boeing (C. C. A. 9th), 106 F. 2d 305;

Fackler v. Commissioner, 133 F. 2d 509;

Harry F. Payer, Tax Court Memorandum Opinion, Docket No. 7701 (P-H 1946, T. C. Memo., Par. 46239).

Numerous other decisions recognizing the foregoing principles that a taxpayer may engage in an incidental business in addition to his principal business, and that the business is that of the taxpayer even though handled through an agent, are listed in Prentice-Hall, Federal Tax Service, 1954, Paragraphs 5575, 5576.

The fact, therefore, that petitioner in the case at bar considered his work as a radio commentator to be his chief means of livelihood did not preclude him from engaging in another distinct business, to-wit. the purchase and sale of literary properties.

It is not necessary that there be great personal activity or the expenditure of large funds upon an office, place of business, etc., in order to determine that one has acquired property and holds same primarily for sale to customers in the ordinary course of trade.

See:

Reis v. Commissioner (C. C. A. 6th), 142 F. 2d 900.

The foregoing cases indicate that the principal question to be determined is whether or not the taxpayer actually

acquired the property in the first instance for the purpose of offering same for sale to customers, or in the alternative, after having acquired the property, thereafter held same primarily for the purpose of sale to customers, as distinguished from holding same for purposes of investment.

The fact that in the case at bar petitioner had been wholly unsuccessful in selling any of the literary properties from the time that he acquired same in 1937 until he disposed of them in 1945 does not affect the conclusion that he had acquired and was holding such properties for resale and was, in a limited sense, carrying on a business, notwithstanding that the business was without profit during the years in question.

See *N. Stuart Campbell,* 5 T. C. 272, wherein the court made this pertinent observation:

> "Obviously the inability to rent or sell the property at a profit during the taxable years does not take from the venture its business character * * *."

See, also,

Leland Hazard, 7 T. C. 372.

It has often been held by the Courts, particularly in the more frequent cases which arise involving real estate, that a taxpayer may be considered as regularly engaged in business even though no sales have been made for several years. Business adversity or failure of anticipated sales does not change the primary purpose for which the property was acquired and held, and does not convert it into an investment.

See:

P-H Federal Tax Service, 1954, *supra,* Par. 5587.

In the light of the foregoing decisions, and the facts of this case, it should be concluded that when petitioner purchased the stock of literary properties involved with the intention and purpose of reselling stories therefrom for the purpose of realizing a profit, and immediately thereafter held and offered them for such purpose, he embarked, to a limited degree, upon a separate and distinct business from his other activities. The properties which he purchased literally as well as actually constituted a "sock in trade" and he held same for one and only one purpose, namely, to sell same to customers. The mere fact that the business of selling such intangibles as literary property rights is not a commonplace or ordinary one, and does not involve the same problems and requirements as are confronted by merchants of such merchandise as clothing, groceries, etc., does not mean that it should not be recognized for tax purposes as the business which it is.

It is an undeniable fact that petitioner lost the sum of $4,750.00 as a result of this unsuccessful business venture. He should be permitted to deduct such loss in full. "The taxpayer as well as the Commissioner of Internal Revenue is entitled to the benefit of the rule" and principles announced in the foregoing cases.

Alfons B. Landa v. Commissioner, supra.

Conclusion.

For the reasons hereinbefore stated, it is respectfully submitted that the decision of the Tax Court should be reversed, and that it should be determined by this Court that there are no deficiencies in petitioner's income tax for the years 1944, 1945 and 1946, with the exception that petitioner's deduction claimed on his income tax return for the year 1944 in the sum of $9,000.00 representing alimony payments should be reduced to the sum of $7,-200.00, which sum represents the payments made by petitioner during the year 1944 subsequent to the divorce decree of March 20, 1944. Petitioner has conceded in these proceedings that he was not entitled to deduct the payments aggregating $1,800.00 made by him prior to the time the divorce decree was rendered.

Respectfully submitted,

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